$50.00 ANNUALLY
40 Letters Per Year

DOW THEORY LETTERS INC.

"The Market as Interpreted under the Dow Theory"

RICHARD RUSSELL
P. O. Box 15196
San Diego 15, California

Registered with the Securities and Exchange Commission

All Rights Reserved

THE MARKET: The feature of the market over the past few weeks has been the excited inter-day rallies by such stocks as Chrysler, RCA, Curtis, U. S. Steel and Parke Davis in response to some published news story, following which the respective stocks sink back (often to their lows for the day). To paraphrase an old joke, we might ask: "Daddy, where do the people get all the money to buy Chrysler every time it runs back to 50 on more bullish auto news?"

But aside from a few isolated areas of excitement, the general market seems to be "suspended", held immobile and listless between a flood of optimistic domestic news (record corporate earnings, record personal income, construction, new cars, etc.) and a potential outpouring of bearish international news (Viet Nam, Chile, Cuba, etc.).

Under the guise of a sluggish trading range, however, a grim struggle has been underway on the New York Stock Exchange since April 6, 1964. This "struggle" can easily be seen on Chart # 1. Note that the Industrial Average rose to an all-time high on April 6 (A on chart), accompanied by a 1964 high for the majority of stocks on the N. Y. S. E. as measured by the A-D ratio. A mild decline ensued, followed by another new Industrial high (B), a high which the A-D ratio refused to confirm. This lead to a sharp reaction to an Industrial low of 810. 77 on April 30. A new rally carried Industrials to an historic peak of 830. 17 on May 7 (C), but again the A-D ratio refused by a wide margin to confirm.

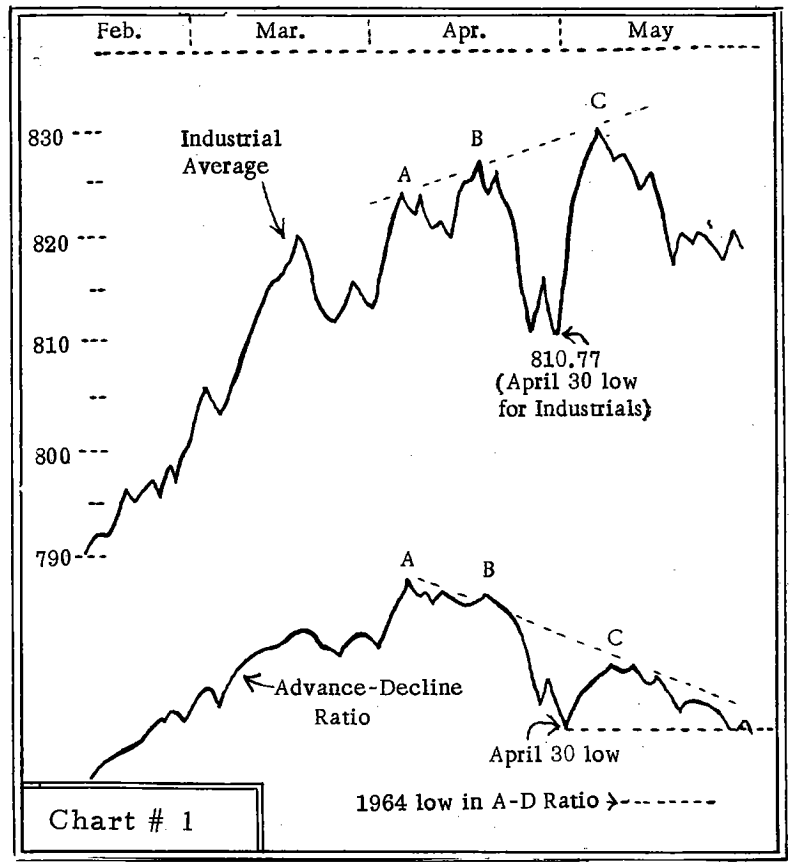


Chart # 1

As mentioned frequently in past Letters, the series of three successive peaks in the Industrial Average against three lower peaks in the breadth index constitutes the technical formula for a bearish breadth-price divergence. Completion of the divergent structure requiries that (following the third peak) the A-D ratio break to a new low (in this case, below the April 30 low as shown on the chart).

On June 1, after flirting with the April 30 low for three days, the A-D ratio penetrated that level by the narrowest possible margin. For this reason, the writer feels that more weakness should be required

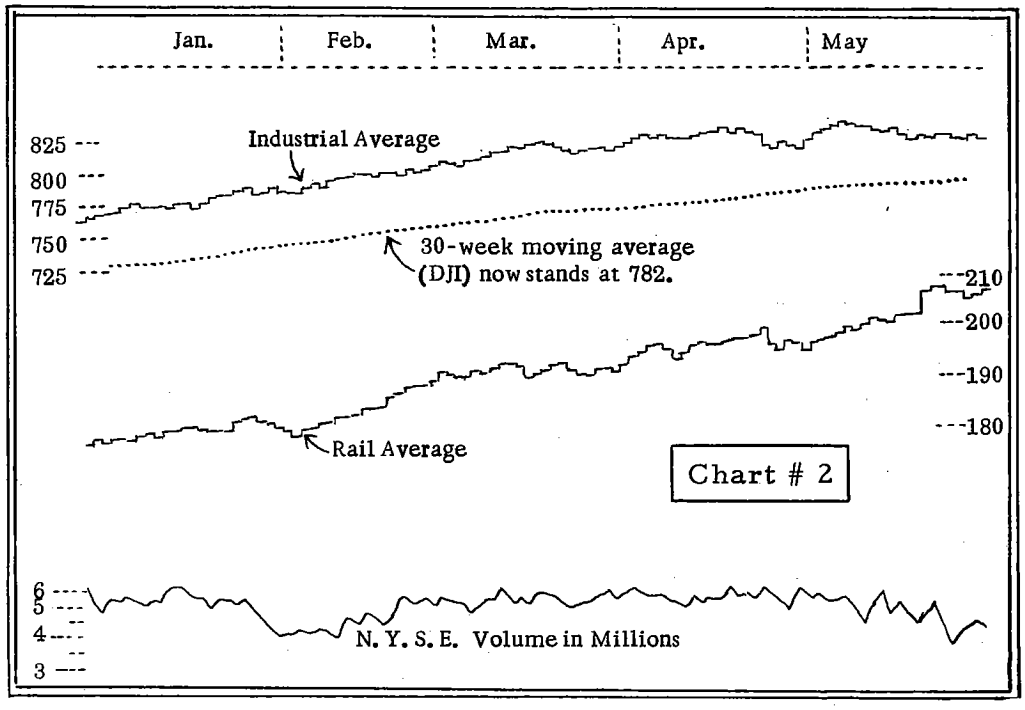


Chart # 2

before concluding that the April 30 low on the A-D ratio has been decisively broken.

Nevertheless, because a price-breadth divergence is so close to completion (this is written June 1 — after the close), it would be well to review the history of past divergences. It must be stressed that while all major market declines have been accompanied by breadth-price divergences, not all such divergences set off major declines. The divergences of November, 1919; September, 1929; August, 1937; and March, 1962 resulted in severe crashes. The divergences of June, 1948; May, 1956; July, 1957; May, 1959; January, 1960; and September, 1963 produced secondary reactions of varying intensity. The mildest of the actions following a breadth-price divergence occurred in June, 1948; May, 1956, and September, 1963.

* * * * *

The decline of June 1 which has taken the A-D ratio back to the April 30 low has also taken the breadth index to within a short distance of a new low for the year (a new 1964 low would constitute a horrendous performance). Meanwhile, the two Averages are still showing divergent tendencies with Rails portraying a picture of much greater strength than Industrials. From the standpoint of Dow's Theory, a joint bettering of the recent 830.17 and 207.31 peaks for Industrials and Rails would be a bullish indication. Conversely, a breaking of the 817.28 and 205.43 levels would be bearish, and bearishness would be greatly heightened if Industrials then cracked the 810.77 low recorded on April 30.

* * * * *

Letter 253 contained a study of the "Momentum Index" (extra copies of that Letter are available; please send self-addressed stamped envelope). The Standard & Poor's 421 Industrial Index closed out this month at 85.37, up from 84.41 at the end of April. This was not enough to help the Momentum Index, however, which dropped to a new low of 115 (down from 116 last month). This Index continues bearish.

THE LONG WAIT: It is widely believed (particularly among professionals) that the 1962-64 rise is fated to end in a speculative "blow-off". This belief has been nurtured (1) by the simple fact that a number of popular investment services have been promising their readers that a speculative finale is in the cards; (2) by the historical observation that many major rises have, in fact, terminated amid an air of excited activity and speculation; (3) by the further belief (held by a small minority) that we are now seeing the tail-end of the whole post-war bull cycle, and that the probabilities are that an upward cycle of such extraordinary duration and extent will end with a "bang" — rather than a "whimper".

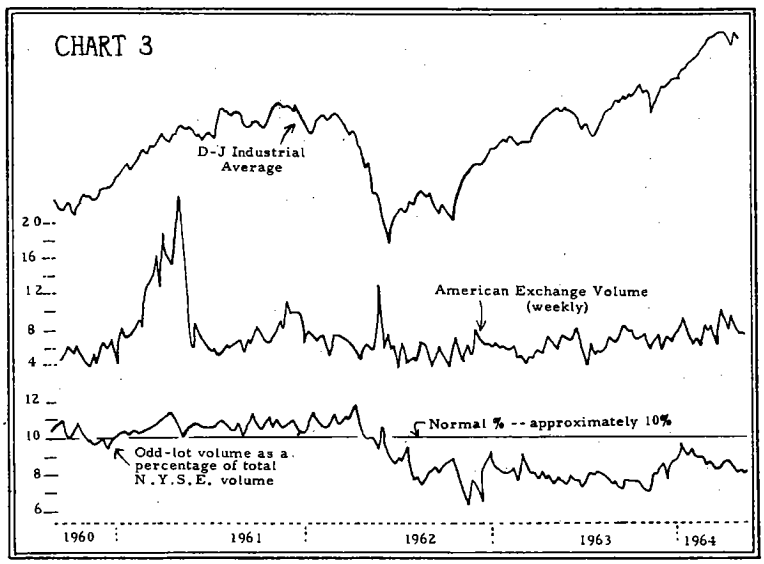
My comments in Letter 253 regarding breadth on the American Exchange as a barometer of speculative sentiment aroused a good deal of interest from readers. I am augmenting those comments with two other studies of public participation (Chart #3), volume of transactions on the (speculative) American Exchange, and odd-lot volume as a percentage of total volume on the N.Y.S.E.

As seen on the chart, the last real excitement on the Amex occurred in the first half of 1961. During that period, the Amex produced week after week of volume in the 10 to 20 million share class. In contrast, volume on the Amex is currently running below 7 million shares per week.

The odd-lot study on Chart 3 would seem to confirm the Amex volume study. Normally, odd-lot volume tends to run about 9 1/2 to 10 percent of total N.Y.S.E. volume. But we note that since the 1962 crash, odd-lot volume has averaged about 7 1/2 to 8% of total Big Board volume. In other words, since 1962 the odd-lot public on the senior Exchange has been conspicuous by its absence.

The failure of the public to "take the bait" during 1962-64 has caused many (perhaps the majority) of analysts to predict that the best and most speculative part of the rise lies ahead. "It is only a matter of time," we are told, "before the little fellow takes note of all the bullish newspaper stories, pulls the money out of his savings bank, and high-tails it down to Wall Street."

While not completely skeptical, this writer would prefer to see tangible evidence (or at least a few hints) of this widely predicted event. In earlier Letters I commented to the effect that the crowd has not (in the past) returned to the market following a true crash. Events since 1962 have not yet disproved that historical observation (it took 7 years after 1929 for the crowd to come back; it took 8 years after 1937 to bring the public back; it took 10 years after 1946 to bring the public into Wall Street again).



Nevertheless, no two periods are exactly alike, and the question arises: "What could occur now which would be of major interest to traders and investors?" The following thoughts have been going through my mind: the total short interest on the N.Y.S.E. is historically high at 6.5 million shares. Furthermore, the odd-lot public is still selling on balances, and odd-lotters are tending to increase their

selling whenever the market declines. Thus, the "psychology" of the market would seem to be one of skepticism — a background favorable to higher, rather than lower, prices.

But against this encouraging situation, the breadth of the market remains definitely poor. Again and again we note that the mass of issues on the N.Y.S.E. run into trouble whenever the A-D ratio pushes into the vicinity of its May, 1963 high. A "technical stalemate" seems to have materialized. In the face of a long parade of bullish business news, stocks have stopped responding. This would suggest that the greatest part of any and all forthcoming good news has already been discounted. In the past, this type of technical and fundamental situation has often lead to a trading range and an eventual breaking of that trading range on the downside.

Along these lines, it is worth noting that the Industrial Average has been fluctuating within the 800-830 range for the past three months, Rails have been moving steadily higher, and the A-D ratio (since early April) has been declining.

Does all this eliminate the possibility of the aforementioned blow-off? Not necessarily: if an important decline succeeded in getting price and breadth into "gear" again, the resultant "oversold market condition" could lay the groundwork for a subsequent speculative blow-off. In other words, an important decline could put the market in a position whereby the public (and the professionals) were convinced that stocks were "on the bargain counter again." Heavy and continuous buying of these "bargains" together with an impressive advance in breadth and the Averages could conceivably set the stage for a subsequent speculative explosion.

But I remain exceedingly skeptical about a blow-off from this level. Breadth has shown itself to be unwilling to rise above the recent April (high) area, and I do not for the life of me see how the public can be expected to become enthusiastic about a market in which the majority of stocks are getting nowhere.

By the same token, despite the continued bullishness of most of my colleagues in the investment business, I have seen a multitude of net losses in brokerage accounts over the past few months. But the nonsense continues, and Wall Streeters continue to "pooh pooh" the declining trend of breadth, a trend which has continued for over a year.

SUNDRY THOUGHTS: It is a remarkable fact that today's young men and women of voting age represent the first generation in U.S. history to have grown up entirely within boom times. This very unique situation could have important effects on the political and economic future of the U.S.

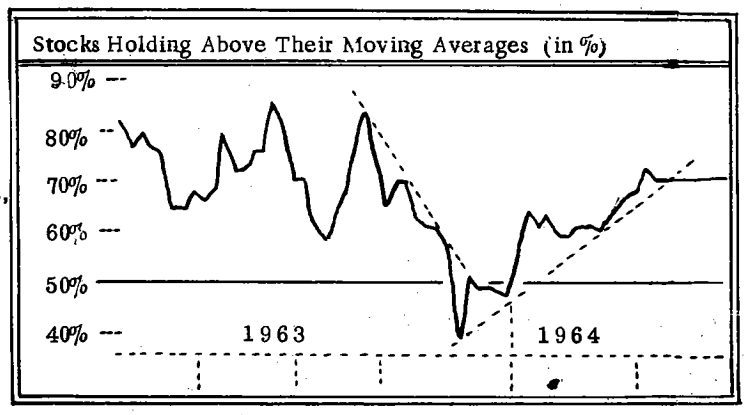
* * * * *

During 1949-50 the average U.S. citizen was living conservatively, while preparing for the "coming post-war depression", a depression which never materialized. It is interesting to compare the following figures: disposable personal income in 1950 was $207. (billions); disposable income in 1963 was $402. — representing an increase of 93%. Against this, total consumer debt in 1950 was $21. (billions), but total consumer debt by 1963 has risen to $70. — a rise of 226%. In 1950 auto installment debt was $6. (billions); in 1963 this auto debt has risen to $22., a rise of 263%. Finally, mortgage debt in 1950 was $72. (billions), and the rise in 1963 was to $281., an increase of 286%. In other words, since 1950 disposable income has risen a respectable 93% but the major debt catagories have all risen over 200%. It would seem that the average U.S. citizen is now committed to "spending tomorrow's inflated dollars today"; in a phrase, he is fully prepared for continuing inflation.

* * * * *

"Blue-ships" vs. the mass of corporations: latest statistics show that of approximately 1.3 million U.S. corporations, 8 produce 25% of all U.S. corporate profits! Another breakdown shows the 72 corporations produce 43% of all U.S. corporate profits. By the same token, the current breadth-price relationship is showing us an interesting picture. On chart 1 (page 1) we see that the big corporations (Industrial Average) are doing extremely well but that the medium to smaller companies (A-D ratio) are finding the going rough. Conclusion: the economy will not be in obvious trouble until the heavily-weighted "big corporations" start floundering.

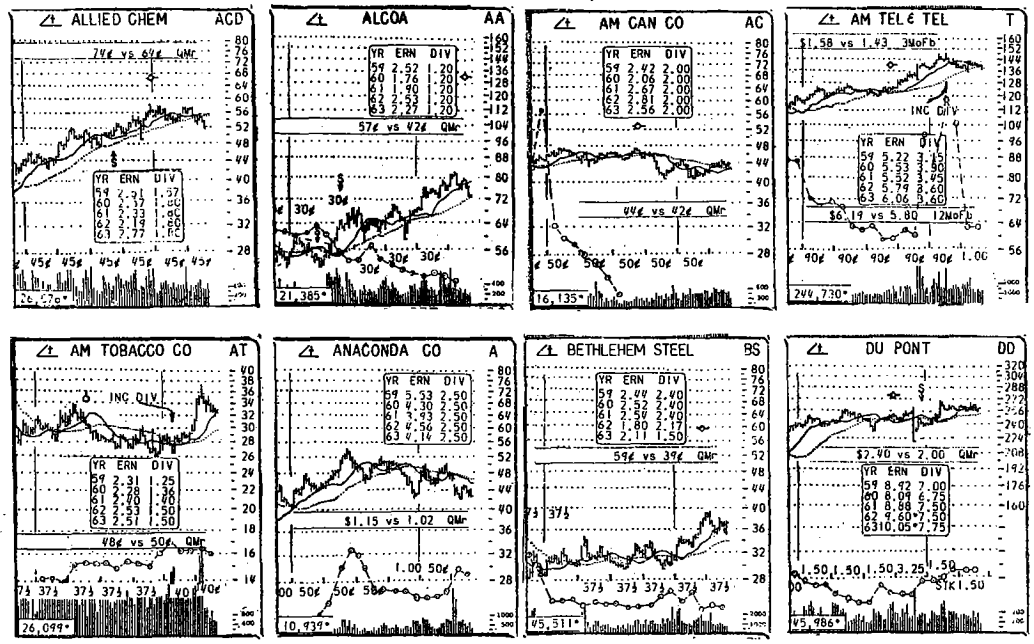
STOCKS: Of 432 stocks which are tabulated here weekly, 300 (70%) are holding above their long-term or 200-day moving averages (no change from last week). As long as the percentage is above 50% (see chart), this study remains bullish.



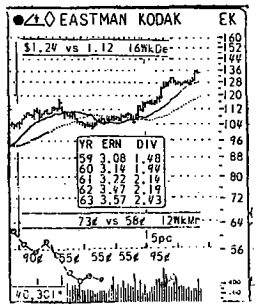
On a careful analysis of 179 leading stocks, I tabulate 74 (42%) to be in continuing bull trends, 63(35%) to be in sideways trends, and 42 (23%) to be in bear trends. In other words, 42% are in bullish trends and 58% are in sideways or bear trends. Surprisingly, of 45 leading stock groups, 23 (slightly more than half) are now below their 10-week moving averages and must be rated bearish. Strongest groups are Food Stores, Gas, Farm Machinery, Soft Drinks (although the rising trend is getting very old here), Heavy Machinery, Movies, Retail Chains and

Rails. Weakest groups are Coal, Drugs, Aluminum, Copper and Mining (this could be an important change), Auto Equipment, Finance, Radio and TV.

While I have commented a good deal about the general list of stocks (which are not now acting well), this might be a good time to start reviewing the real strength of the industrial sector of the market — the D-J Industrial stocks. What these stocks do now will probably determine the next direction of the overall market. Weekly charts of the first 9 Dow stocks are shown on this page with reviews beginning below:



ACD acts bearishly, has broken below its 200-day moving average (dotted line) and also below its March low. Relative strength (R. S.) on ACD has dropped to lowest point since early 1963..... AA, after rising to approximately its 1961 high, now appears to be in at least short-term trouble. A small "head-and-shoulder" pattern has taken the stock back to its February low..... Big T, after rising to an all-time high in February, now acts poorly. R. S. has dropped to lowest level since mid-1963 and stock is just below its 200-day moving average at 140.... AT is recovering from the collapse which struck the entire Tobacco group. AT acts about the best in the Tobacco group and it recently reversed a two-year declining R. S. line. Stock should hold, and volume has dried up drastically on latest minor decline.... A has been beset by the Chilean crisis and the possible take-over of its Chilean copper reserves. Stock has support at 42, but R. S. line has dropped to a five-year low. A appears to be in a major bear trend..... AC has been sinking gently lower since its early 1963 high. Stock is sitting on its 200-day moving average and appears to be neutral-bearish..... BS recovered to just under its 1962 low, then turned down. Two weeks ago BS broke below its 10-week moving average (solid line). Nevertheless, the stock should be considered bullish as long as its holds above 35..... Chrysler (chart shown in recent Letters) is still trying to rise above 50 and hold above that level. So far, the sellers above 50 have been "dead right".... DD is just below its 10-week moving average, but the fact that the stock has broken below a two-year R. S. line is not hopeful. A push above 272 or a break below 252 will determine the next major move for DD..... EK has been rising rather steadily since its 1962 low. The stock has just pushed above its all-time (1960) high of 134. We will now see whether there is to be a "double top" for EK or a major rise from here.



It is worth noting that only 10 or the 30 Dow stocks have bettered their 1956-61 highs during the 1962-64 rise. Of the 10 stocks reviewed in this Letter, only one is clearly bullish — EK. (More Dow stocks next issue).

At right are two potential shorts, Litton and St. Regis paper. Litton has formed a "head-and-shoulders" top after falling out of a great "rising wedge". St. Regis has dropped out of a large triangle. R. S. on both stocks is very poor, but shorts should be protected with stops 10% above current prices.

NOTE: If there is any plurality of decline over advances today (June 2) the A-D ratio will definitely have broken the April 30 low.

Charts of LIT and SRT courtesy of Traders Research, 1431 Pearl Ave., Alton Illinois. Small charts of Dow Stocks courtesy of Quote Digest, 110 N. Lorraine, Wichita, Kansas.